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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. 330.

THE UNITED STATES, *Petitioner*

v.

AUTOMATIC WASHER COMPANY, *Respondent.*

On Writ of Certiorari to the Court of Claims.

BRIEF FOR THE RESPONDENT.

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PRELIMINARY STATEMENT.

This case is one of three to be argued as a group, the other two being *United States* v. *A. B. Leach and Company*, No. 331, Present Term and *Founders-General Corporation* v. *Hoey*, No. 398, Present Term. All three cases involve questions of liability under Section 800, Schedule A(3) of the Revenue Act of 1926 for certain stamp taxes on the transfer of so-called "rights to receive" shares of corporate stock. As will be seen hereinafter, however, the ques-

tion involved in the present case is distinct from the one presented in the other two cases.

Petitioner's citations as to the opinion below, the jurisdiction of this Court and the statutes and regulations involved are correct and are not here repeated.

QUESTION PRESENTED.

Petitioner's brief states somewhat inaccurately the precise question involved. The assets of A Corporation were conveyed to the respondent corporation which agreed to deliver its stock therefor in such names and for such amounts as might be specified by the irrevocable attorney-in-fact for A's stockholders. Pursuant to the direction of such attorney-in-fact, respondent issued certificates for part of the stock in the name of said attorney-in-fact. Did this transaction involve a taxable transfer by the stockholders to their attorney-in-fact within the meaning of Section 800, Schedule A(3) of the Revenue Act of 1926?

SUMMARY OF FACTS.

On June 22, 1928, one Nelson, a substantial stockholder and officer of the Automatic Electric Washer Company, hereinafter referred to as the old company, entered into an agreement with a firm of investment bankers, the substance of which was that the old company would be reorganized and the bankers given an option to purchase 40,000 shares of new common and 34,538 shares of new preferred stock out of a proposed recapitalization of 180,000 shares of common and 40,000 shares of preferred stock of a new or reorganized company.

On September 17, 1928, Nelson secured from all the stockholders of the old company irrevocable (to November 15, 1928) powers of attorney, the material and identical provisions of each authorizing him, in connection with the reorganization, to

"receipt for and receive * * *, and to sell, exchange or dispose of, for me in my behalf any and/or all property or assets so received, including all or any portion of the shares of stock or other securities of the New Company accruing to me, or to which I am or may become entitled by reason of the consummation of any plan of reorganization of the affairs of the Old Company and particularly * * * to sell and dispose of any and/or all such shares of stock and/or securities in consummating the agreement or agreements now existing between the said H. E. Nelson and Folds, Buck & Company." (Tr. p. 8.)

On September 27, 1928, the new company (this respondent) having meanwhile been created, entered into an agreement with the old company whereby the old company agreed to sell to the new company all of its assets in consideration of the new company's issuing to the stockholders of the old company all of its common and preferred stock, *with the following important qualification:*

"In order to carry out this plan * * * each of the stockholders of the old company has irrevocably constituted and appointed H. E. Nelson and W. N. Gallagher his attorneys in fact to receive the respective securities of the New Company to which such stockholder may be entitled and to make sale of that portion thereof to be contributed by such stockholder for the purpose of carrying out said agreement of sale with the Bankers * * *.

"Accordingly, the New Company, * * * shall issue such certificates in such names and for such amounts as shall be specified in the joint order of the said H. E. Nelson and W. N. Gallagher, the attorneys in fact * * * and deliver the same to said attorneys in fact, * * *." (Tr. p. 7.)

In substance, the new company acquired all of the old company's assets upon its agreement (forthwith executed) to issue 100,000 shares of its new common to the old stockholders and 40,000 shares of new common and 34,538 shares

of new preferred or a total of 74,538 shares to Nelson for ultimate sale to the bankers.

Of these 74,538 shares, 13,173 shares were Nelson's own *pro rata* contribution, as a stockholder, to the total shares sold to the bankers. Upon these transactions, as the Court of Claims pointed out (R. p. 12), five separate stamp taxes were paid, viz:

1. On the original issue of all the stock by the new company;

2. On the old company's transfer to its stockholders and Nelson of its right to receive the new company's stock (*Raybestos-Manhattan* v. *United States, infra*);

3. On Nelson's transfer to the bankers;

4. On the bankers' sale to the public; and

5. On the stockholders' alleged transfer to Nelson of their "rights to receive" the 74,538 shares ultimately sold to the bankers.

Respondent makes no complaint as to the first four taxes, this case involving only the correctness of the fifth tax above-mentioned. As to that tax, petitioner now admits that it was improperly collected on the 13,173 shares which Nelson, as a stockholder, personally contributed to the 74,538 shares sold to the bankers and *now concedes that the judgment of the Court of Claims should be affirmed to that extent.* Petitioner contends, however, that, as to the balance of 61,365 shares, the tax was lawfully collected under Section 800, Schedule A(3) of the Revenue Act of 1926.

ARGUMENT.

Schedule A(3) of Section 800 of the Revenue Act of 1926, so far as is here material, imposes a stamp tax of two cents per share on the

> "transfer of legal title * * * to rights to receive such shares."

This Court has heretofore considered this provision in *Raybestos-Manhattan* v. *United States,* 296 U. S. 60. The Government relies upon that case as supporting its position here. We rely upon it as supporting respondent's contention. The court below also relied upon it as supporting its conclusion, as to which the Government seeks this review. Since it is apparent, therefore, that a correct interpretation and application of the *Raybestos-Manhattan* decision should determine the case at bar, it seems proper at this point briefly to analyze its scope and underlying philosophy.

In the *Raybestos-Manhattan* case, a corporation sold all its assets to another corporation, the consideration being the issuance by the purchasing corporation of its stock directly to the stockholders of the selling corporation. This Court held that the old company had, in effect, transferred its rights to receive this stock to its stockholders and had thus incurred the liability imposed by Schedule A(3). For, said this Court, after the conveyance of all its assets to the new company, the *old company alone was entitled to receive the new shares* and for this reason had "the power to command the disposition" of them. The transaction, in legal effect, was no different than if the old corporation had received the new stock and then transferred it to its stockhoders, in which event, a tax would concededly have been incurred. The tax could not be avoided by any procedure that would short-cut or obscure the "several legal relationships of the parties" for, said the Court,

> "The reach of a taxing act whose purpose is as obvious as the present is not to be restricted by technical refinements."

Thus, in underlying principle, the Court held that *substance* and not *form* should control.

These being the basic principles of *Raybestos-Manhattan,* it is now necessary to apply them to the case at bar and to demonstrate hereinafter that

1. The broad underlying principle of *Raybestos-Manhattan* refutes the Government's contention in the case at bar and that

2. The narrower technical rule of *Raybestos-Manhattan* likewise defeats the Government's claim. The stockholders never acquired any "right to receive" the bankers' stock and could not have transferred "legal title" to a non-existant right.

The Underlying Principle of Raybestos-Manhattan Refutes the Government's Contention.

As seen above, the broad principle announced by this Court in the *Raybestos-Manhattan* case is that, in transactions of the sort here involved, short-cutting cannot be permitted to obscure the "several legal relationships" that would have been more clearly established by separate transactions and hence that the application of the tax must turn upon the *substance* rather than the *form* of the transaction.

What, then, was the alternative (and more elaborate) procedure that might have been pursued in the case at bar and what would have been the effect of such alternative procedure?

If the "several legal relationships", which the Government contends existed in the case at bar, had been established by separate transactions, the procedure would have been as follows:

1. Each stockholder would have received two stock certificates, *each in his own name*, one certificate representing shares to be retained by him and the other certificate representing shares to be sold to the bankers.

2. Each stockholder would then have turned over to Nelson, his attorney in fact, an individual certificate in his own (the stockholder's) name, representing the bankers' shares and each of these certificates would then have been endorsed and delivered by Nelson, *as attorney in fact.*

It cannot be contended that any tax would have accrued upon the delivery to Nelson of such individual certificates. Instead, presumably as a matter of convenience, one certificate was issued to each stockholder covering the shares to be retained by him and a single certificate was issued to Nelson, as attorney in fact, this latter certificate covering the total number of shares to be contributed by all the stockholders for sale to the bankers. This is the transaction which the Government claims became taxable under the doctrine announced in *Raybestos-Manhattan*.

In that case, the procedure adopted sought to eliminate one technical transaction which was clearly taxable, i. e., the original issuance of stock to the old company and its transfer thereafter to its stockholders. This Court said that *substance* and not *form* should control and, therefore, sustained the tax, even though the stock had been issued directly to the stockholders.

In the case at bar, the procedure adopted dispensed with a transaction which, *even if it had been gone through with, would have produced no tax.* The Government in this case, however, insists that *form* rather than *substance* should control. This is, indeed, a gross distortion of the doctrine of *Raybestos-Manhattan* and one that is utterly repugnant to the philosophy which underlay the Court's conclusion. The Government's contention here cannot possibly be sustained upon that theory of the *Raybestos-Manhattan* decision.

The Stockholders Never Acquired Any "Right to Receive" the Bankers' Stock and Could Not Have Transferred Legal Title to a Non-Existant Right.

The tax in controversy is imposed upon the "transfer of legal title * * * to rights to receive" shares of stock. It is respondent's contention that, under one of the subordinate principles of *Raybestos-Manhattan*, the stockholders never acquired any "rights to receive" the bankers' stock and consequently could not have transferred to Nelson any

legal title to it. In this respect, the issue is quite different from the one said to exist in the two companion cases to be argued with the present case.

In both the *Leach* and *Founders-General* cases, the taxpayers had subscribed for shares of stock in certain corporations and, as such subscribers, had acquired "legal title" to the "rights to receive" the shares thus subscribed for. In each of those cases, the taxpayer instructed the respective corporations to issue the shares in the name of a third person who had no beneficial interest in the shares, but who was, in each instance, merely a temporary nominee. The question in those two cases was whether the issuance of stock to the bare nominee of a person who had the *legal right to receive the shares himself,* constituted a taxable transfer under the Act.

In the case at bar, as will presently be seen, the stockholders of the Automatic Washer Company *never had any legal or other right or title to the "right to receive" the shares of bankers' stock* which they are alleged to have transferred to their attorney in fact. *Hence, they did not transfer and could not have transferred "legal title" to a non-existant right.* It is, therefore, immaterial, in the case at bar, whether the transfer to a nominee of "rights to receive" stock is taxable or not; for in this case *no legal right or title ever vested in the stockholders.*

In *Raybestos-Manhattan,* this Court held that where one corporation sells its assets to another corporation in return for the purchasing corporation's stock, the "right to receive" such stock *belongs to the selling corporation* which has "the power to command the disposition of the shares" and where such selling corporation stipulates that the stock is to be issued directly to third persons, it has nonetheless transferred its primary "right to receive" such stock and has thus incurred a tax liability. Respondent recognized this principle and agreed to the tax on the transfer by the old company of its "right to receive" *all* of the new stock of which 100,000 common shares were issued to the old

stockholders and the balance to Nelson. The Government, however, contends that the old stockholders had the "right to receive" *all* of the new stock and that they, in turn, transferred to Nelson their "right to receive" the bankers' stock, thus incurring an additional tax.

The complete answer to this contention is that under the rule of *Raybestos-Manhattan,* the stockholders acquired no "right to receive" any stock *except under the agreement of September 27, 1928 between the old and new companies.* On September 17, 1928, however, all the stockholders had irrevocably relinquished every claim or right to receive the bankers' stock and the agreement of September 27th expressly recognized, *as one of the essential conditions of the reorganization,* that the old stockholders had irrevocably waived any claim to receive the bankers' stock, as such.

Hence, the powers of attorney of September 17th, (which are claimed to be the instruments effecting the transfer of the stockholders' "rights to receive" the bankers' stock) were at most *mere waivers of any claims that the stockholders might later acquire to receive the bankers' stock.* They certainly did not effect any "transfer of legal title" to "rights to receive", for no such rights existed on September 17, 1928. The Court of Claims very properly, therefore, said that the Government's argument, reiterated in this Court,

> "overlooks the decision of the Supreme Court in the case of Raybestos-Manhattan Co. v. United States, 296 U. S. 60. *The right to receive the stock of the new company was under the foregoing* decision vested in the old company * * *." (Italics ours.)

Respondents' position finds added and directly pointed authority in the decision of the Ninth Circuit in *McLaughlin, Collector* v. *Coos Bay Lumber Company,* 80 Fed. (2d) 763. In that case the bondholders of an insolvent corporation transferred title to certain bonds to a bondholders' protective committee which later succeeded in effecting a

reorganization under which the corporation issued to the bondholders' committee shares of new stock in the reorganized corporation in exchange for the old bonds. The Government claimed that these new shares were the property of the old bondholders and that the old bondholders had transferred to the protective committee their rights to receive the new shares, thus subjecting the transaction to a tax under Schedule A(3).

In denying the Government's contention and in holding that no tax was incurred, the Circuit Court of Appeals said:

> "In the instant case, we think the controlling factor is the determination of the *time when the right to receive the stock came into existence.* When the bondholders deposited their bonds, they conveyed to the members of the committee the legal title; * * *. When the plan was approved by appellee, a right to receive stock was vested in the owners of the title to the bonds who would be and were the members of the committee. *And since the right to receive the stock was not vested in the bondholders, they could not transfer such right.* (Italics ours.)

In the case at bar, the old stockholders never became entitled to receive any new shares until after the agreement of September 27th. *Raybestos-Manhattan* v. *United States, supra.* Prior to that time they had all *irrevocably agreed that Nelson should receive and sell the bankers' shares.* On September 27th, therefore, the stockholders *had no right or title to the bankers' shares which was capable of transfer.* In other words, they had already relinquished *"the power to command the disposition of the shares"* which this Court has said in the *Raybestos-Manhattan* case is the criterion of the "right to receive".

Therefore, the question presented in this case is entirely distinct from the one inhering in the *Founders General* and *Leach* cases. In the latter cases, the question is whether the transfer to a nominee of an *undisputed* right to receive stock is taxable. In the case at bar, the question is whether any

"right to receive" ever *existed at all.* This latter question, it is submitted, has already been answered by this Court in *Raybestos-Manhattan* v. *United States.*

CONCLUSION.

Upon all the foregoing, it is believed that the judgment of the Court of Claims should be affirmed in its entirety.

Respectfully submitted,

JESSE I. MILLER,
Attorney for Respondent.

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MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF.

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MAY IT PLEASE THE COURT:

The undersigned, as counsel for Middle States Petroleum Corporation, respectfully moves this Honorable Court for leave to file the accompanying brief in this case as *Amicus Curiae.*

THADDEUS G. BENTON,
Counsel for
Middle States Petroleum Corporation,
as Amicus Curiae.